APPENDIX A

IN THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF TENNESSEE, WESTERN DIVISION

Civil No. C-71-97

THE TROXEL MANUFACTURING COMPANY, *Plaintiff*

v.

SCHWINN BICYCLE COMPANY, *Defendant*

Memorandum Decision

In this diversity action, Troxel sues to recover royalty payments made by it to Schwinn on a patent that has been held to be invalid, and the matter is before us on Troxel's motion for summary judgment.

Troxel entered into an agreement with Schwinn on June 1, 1967 under which Schwinn licensed to Troxel the non-exclusive right to manufacture and sell bicycle seats covered by Schwinn's patent D-204,121 and under which Troxel was obligated to pay a royalty to Schwinn on each seat sold. The negotiation of this license agreement followed notice from Schwinn to Troxel that the latter was infringing the patent. Schwinn also released Troxel with respect to claimed infringement prior to the license agreement. Thereafter Troxel paid the royalties to Schwinn and, on occasion, Troxel's request and pursuant to the license agreement, Schwinn took action against alleged infringers of the patent.

In the case of *Schwinn Bicycle Co.* v. *Goodyear Tire and Rubber Co.*, 160 USPQ 587, the United States District Court for the Northern District of California on January 8, 1969 entered a judgment holding this patent invalid. Troxel then advised Schwinn that it was escrowing the royalties pending the determination of Schwinn's appeal. Schwinn thereupon sued Troxel in the United States District Court for the Northern District of Ohio on December 15, 1969 for past due royalties and to require Troxel to continue to make quarterly payment of royalties. This

action was settled and dismissed by an agreement under which Troxel did pay such past due royalties and did continue making quarterly payments.

On December 22, 1970, the Court of Appeals for the Ninth Circuit affirmed the District Court's holding of invalidity (168 USPQ 258) and shortly thereafter Schwinn advised Troxel that it was accepting such determination as final, that it considered the license agreement as terminated and that no royalties would thereafter be due. Troxel paid no royalties for the last quarter of 1970.

In this action, Troxel sues for all of the royalties it has paid under the license agreement or, alternatively, all royalties it has paid with respect to seats sold after the entry of the judgment in the District Court for the Northern District of California on January 8, 1969. Schwinn has answered, denying that it should be required to pay back any of such royalties to Troxel, and has counterclaimed for the royalties on seats sold in the last quarter of 1970 prior to the judgment of affirmance in the Court of Appeals for the Ninth Circuit on December 22, 1970.

Troxel has filed a motion for summary judgment to which Schwinn has filed a response, both of which are supported by affidavits and briefs, and argument has been had on the motion.

Troxel is basing its claim for recovery of all royalties paid on the decision of the Supreme Court in *Lear Inc.* v. *Adkins,* 395 U.S. 653 (1969). There the Supreme Court held, overruling its prior decisions to the contrary, that a licensee of a patent may, in a suit by the licensor to collect royalties, attack the validity of the patent and that, upon a determination that the patent is invalid, the licensee would be excused from paying any royalties accruing since the patent issued. Troxel, alternatively, with respect to royalties accruing after the judgment in the district court in *Schwinn* v. *Goodyear* on January 8, 1969, is relying on the doctrine of eviction as such doctrine was

recognized in this Circuit even before *Lear* by the cases of *Drackett Chemical Co.* v. *Chamberlain Co.*, 63 F.2d 853 (1933) and *Scherr* v. *Difco Laboratories, Inc.*, 401 F.2d 443 (1968). Stated generally, this doctrine of eviction is that upon an adjudication in litigation in a court of competent jurisdiction, to which the licensee of a patent is not a party, that the licensed patent is invalid, the licensee may consider itself as having been "evicted" and thereafter may properly not pay royalties. Schwinn recognizes the applicability of this doctrine of eviction but contends that it did not become effective in the instant case until the affirmance by the Court of Appeals on December 22, 1970. Since, as will be seen, we take the view that a proper interpretation of *Lear* requires entry of summary judgment for Troxel as to all royalties paid to Schwinn, we need not deal further with this doctrine of eviction.

Before discussing the holding in *Lear*, we should point out that Schwinn has assumed in its dealing with Troxel, and indeed in presenting its argument that *Lear* does not require it to pay back these royalties to Troxel, that its legal position is the same as it would be if the final determination of invalidity in the California federal courts operated as res judicata as between it and Troxel. We mention this because the opinion in *Scherr* by our Court of Appeals (401 F.2d at 446, note 4) reminds us of the principle that, while it may be the basis of an eviction, that adjudication in the Ninth Circuit is not res judicata as between these parties, citing *Triplett* v. *Lowell*, 297 U.S. 638 (1936). In accordance with the assumption under which Schwinn has pitched its argument, we test Schwinn's position as if the adjudication in the Ninth Circuit were res judicata between these parties.

As stated, the decision in *Lear*, *supra*, is that a holder of a license for the use of a patent may attack its validity and that, upon the establishment of its invalidity, is excused from paying royalties. Schwinn contends that the decision does not cover the instant situation in which Troxel

is seeking to recover royalties already paid. Troxel contends, on the contrary, that while the Supreme Court in *Lear* did not deal with the specific situation involved here, the doctrine of *Lear* is clearly applicable. None of the cases applying *Lear* have dealt with this specific situation. See, for example: *Bendix Corp.* v. *Balax, Inc.*, 421 F.2d 809, 820 (7th Cir. 1970); *Kraly* v. *National Distillers and Chemical Corp.*, 319 F. Supp. 1349, 1352 (N.D. Ill. 1970); *Bull* v. *Logetronics, Inc.*, 323 F. Supp. 115, 121 (E.D. Va. 1971); *Epstein* v. *Dennison Manufacturing Co.*, 314 F. Supp. 116, 124 (S.D. N.Y. 1969). However, we believe that these cases do generally support our understanding of the effect of the *Lear* decision.

The underlying reason for the *Lear* decision, as stated therein is that the federal policy in favor of the public use of ideas that are in reality a part of the public domain must override the doctrine of state contract law that would by estoppel prevent a license holder from claiming invalidity and avoiding the payment of royalties. Considered in this light, we cannot see why the doctrine of *Lear* would not be equally applicable to the instant case in which Troxel is seeking to recover royalties paid for the use of an invalid patent. Schwinn argues that "to extend" *Lear* to allow the recovery of royalties already paid would place an unfair and too great a burden on licensors and would play havoc with the practice of licensing the use of patents. We cannot, however, see why a licensee who has paid royalties should be in a worse position than one who has not. Moreover, the licensor who has to pay back royalties at least has had the use of the licensee's money.[1]

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[1] Troxel actually sues also for interest on the royalty payments from the date of payment. We do not rule on this claim for interest now, and we will hear from the parties further on this issue if necessary. At this point, it seems to us that it might well be equitable and not inconsistent with the involved federal policy, where a licensee is suing to recover royalties paid, to deny such interest except in such cases in which there is wrongdoing on the part of the licensor such as fraud in the procurement of the patent.

There remains the problem as to whether this is a proper case for summary judgment. The facts as outlined at the beginning of this memorandum are not in dispute. We would agree that if the question presented is one as to whether there has been a failure of consideration, as Schwinn would have us view it, this would not be a case for summary judgment. For then, as Schwinn argues, we would have a mixed question of law and fact, which would first involve a determination as to the benefits Troxel actually received under the license during the period royalties were paid and then involve a determination as to whether any lack of benefits amounted to a failure of consideration. But here, as we construe *Lear*, because of the overriding federal policy, we are not concerned with the state contract law doctrine of failure of consideration.[2] Thus we conclude that, applying *Lear* and under the disputed facts, Troxel is entitled to summary judgment with respect to all royalties paid.

A judgment will be prepared for entry.

ENTER this 22 day of November, 1971.

BAILEY BROWN, Chief Judge
Chief Judge

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[2] It should be noted that Schwinn's contention that the issue here is one of failure of consideration would be equally applicable, under state contract law, if Schwinn were suing to recover unpaid royalties and yet the square holding of *Lear* is that, in such a situation, Schwinn would be precluded by the federal policy from making any recovery irrespective of whether there was or was not a substantial failure of consideration.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 72-1106-07

THE TROXEL MANUFACTURING COMPANY, *Plaintiff-Appellee & Cross-Appellant,*

v.

SCHWINN BICYCLE COMPANY, *Defendant-Appellant & Cross-Appellee.*

Appeal from the United States District Court for the Western District of Tennessee.

Decided and Filed August 11, 1972.

Before PHILLIPS, Chief Judge, and TUTTLE* and O'SULLIVAN, Senior Circuit Judges.

PHILLIPS, Chief Judge. This is an appeal from a decision granting summary judgment to a patent licensee in an action for the recovery of royalties paid under the license agreement. The case requires an intepretation of *Lear* v. *Adkins*, 395 U.S. 653 (1969). The opinion of the District Court is reported at 334 F.Supp. 1269. We reverse.[1]

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* Honorable Elbert P. Tuttle, Senior Judge, United States Court of Appeals for the Fifth Circuit sitting by designation.

[1] This Court has been aided by amici curiae briefs which were not available to the District Court, filed by the American Patent Law Association, the New York Patent Law Association, the Patent Law Association of Chicago, the Cincinnati Patent Law Association, the Association for the Advancement of Invention and Innovation and Moses Lasky, Esq., an attorney of the San Francisco Bar. All of the amici briefs support the interpretation of *Lear* v. *Adkins, supra,* adopted by this court in this opinion.

Schwinn Bicycle Company is the assignee of a design patent for a bicycle seat issued to Frank Brilando in 1966. In mid-1967, following notice of infringement, Schwinn and Troxel Manufacturing Company entered into a non-exclusive license agreement under which Troxel was released from liability for past infringement and was licensed to manufacture and sell bicycle seats embodying the patented invention at an agreed per-unit royalty, payable quarterly. Schwinn obligated itself to enforce the patent against infringers.

Troxel notified Schwinn in August 1967 that Fisher Cycle Company was importing and selling infringing seats. Six months later Schwinn instituted an infringement action in the United States District Court for the Northern District of California against Goodyear Tire and Rubber Company, Fisher's vendee. The Brilando patent was held invalid in January 1969, on the grounds of anticipation and obviousness in view of a prior art seat which had been considered by the Patent Office in the course of examination of the Brilando application. *Schwinn Bicycle Co.* v. *Goodyear Tire & Rubber Co.*, 160 U.S.P.Q. 587. Troxel thereupon informed Schwinn that royalties due under the license agreement would be escrowed pending appeal. Schwinn brought suit against Troxel to collect the escrowed royalties. Upon Troxel's payment of overdue royalties and agreement to continue making regular payments, Schwinn dismissed the suit. The decision of the California District Court was affirmed in December 1970, on the issue of obviousness. 444 F.2d 295 (9th Cir.). Schwinn thereupon notified its licensees that no royalties would be due for seats sold after the date of that decision.

Three months later Troxel filed this diversity action in the Western District of Tennessee, seeking recovery of all royalties paid under the agreement, or alternatively, those royalties paid subsequent to the District Court's holding of invalidity, together with interest from the dates of the respective payments, and a declaration that it had no liability

for the payments due from sales during the last quarter of 1970. Schwinn counterclaimed for the unpaid final quarterly royalty payments. Troxel's motion for summary judgment, supported by affidavits showing the foregoing facts, was granted. Schwinn was ordered to refund all royalties with interest from the date of judgment. This appeal followed.

I.

It has been the established rule in this Circuit for nearly forty years that a final adjudication of invalidity of a licensed patent operates as an eviction from the license, terminating the licensee's obligation to continue making royalty payments after that date but giving no right to recoup royalties already paid. *See Drackett Chem. Co.* v. *Chamberlain Co.*, 63 F.2d 853, 855 (6th Cir. 1933). In *Drackett* the patent was held invalid in a District Court decision which was not appealed. *See* 63 F.2d at 854. Absent a showing that Schwinn prosecuted its appeal to the Ninth Circuit in bad faith, the eviction in this case occurred on the date of the decision of the Court of Appeals. *Cf. Scherr* v. *Difco Laboratories, Inc.*, 401 F.2d 443, 445 (6th Cir. 1968).

We are called upon in a case of first impression at the appellate level,[2] to consider the effect of the decision in *Lear, Inc.* v. *Adkins, supra*, 395 U.S. 653 (1969), on the eviction rule of this Circuit. The precise holding of *Lear* was that a licensee was not estopped to interpose the invalidity of the licensed patent as a defense to an action brought by the licensor to enforce the license agreement. *See* 395 U.S. at 656, 671. The District Court in the present case found that "the doctrine of *Lear* would . . . be equally

[2] One District Court reached a result squarely contrary to that of the District Court in the present case. *See Ransbury Electro-Coating Corp.* v. *Spiller & Spiller, Inc.*, 340 F.Supp. 1385, 1391-92 (N.D. Ill. 1972).

applicable" to the case in which a licensee arrested invalidity offensively to recover royalties already paid. 334 F. Supp. at 1271. We believe this to be an unwarranted extension of *Lear*.

The abrogation of the licensee estoppel doctrine was the "decent public burial" of a "doctrine which ha[d] . . . been deprived of life." 395 U.S. at 667. The "clouded history" of the rule is discussed extensively in *Lear* and will not be repeated here. *See id.* at 663-68. The Court reached its decision through extended consideration of the effect of federal patent-antitrust policy on traditional contract law concepts. The conflicting policies involved were placed in sharp focus:

> "On the one hand, the law of contracts forbids a purchaser to repudiate his promises simply because he later becomes dissatisfied with the bargain he has made. On the other hand, federal law requires that all ideas in general circulation be dedicated to the common good unless they are protected by a valid patent."

Id. at 668 (footnote and citation omitted). Recognizing that it was seeking "an acceptable middle ground" which would "accommodate the competing demands of the common law of contracts and the federal law of patents," *id.*, the Court found that:

> "[T]he equities of the licensor do not weigh very heavily when they are balanced against the important public interest in permitting full and free competition in the use of ideas which are in reality a part of the public domain. . . . that the technical requirements of contract doctrine must give way before the demands of the public interest in the typical situation involving the negotiation of a license after a patent has issued. *Id.* at 670-71.

As noted above, in *Lear* the federal policy in conflict with state contract law was "that all ideas in general circulation be dedicated to the common good unless they are pro-

tected by a valid patent." The development of this policy was set forth in *Sears, Roebuck & Co.* v. *Stiffel Co.*, 376 U.S. 225 (1964), and *Compco Corp.* v. *Day-Brite Lighting, Inc.*, 376 U.S. 234 (1964).[3] As noted by the Court:

> "[I]n rewarding useful invention, the 'rights and welfare of the community must be fairly dealt with and effectually guarded.' To that end the prerequisites to obtaining a patent are strictly observed, and when the patent has issued the limitations on its exercise are equally strictly enforced. To begin with, a genuine 'invention' or 'discovery' must be demonstrated 'lest in the constant demand for new appliances the heavy hand of tribute be laid on each slight technological advance in an art.' Once the patent issues, it is strictly construed, it cannot be used to secure any monopoly beyond that contained in the patent, the patentee's control over the product when it leaves his hands is sharply limited, and the patent monopoly may not be used in disregard of the antitrust laws, . . .
>
> "Thus the patent system is one in which uniform federal standards are carefully used to promote invention while at the same time preserving free competition."
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> *Id.* at 230-31 (citations and footnote omitted).

This well developed resolution of the tension between the competing public interests reflected in federal antitrust and patent laws could "not be set at nought" by state law which clashed with its objectives. *Id.* at 229.

Two terms following *Lear*, the traditional procedural "mutuality of estoppel doctrine" set forth in *Triplett* v. *Lowell*, 297 U.S. 638, 642 (1936)—

> "Neither reason nor authority supports the contention that an adjudication adverse to any or all the claims

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[3] *Sears-Compco* held that state unfair competition laws which prohibit mere copying of an unpatented or unpatentable article were void under the Supremacy Clause. *See id.* at 231, 237.

> of a patent precludes another suit upon the same claims against a different defendant. While the earlier decision may by comity be given great weight in a later litigation and thus persuade the court to render a like decree, it is not *res adjudicata* and may not be pleaded as a defense."

—gave way to this public interest. In *Blonder-Tongue* v. *University Foundation,* 402 U.S. 313 (1971), the Court held that a defendant in a patent infringement action could assert the defense of *res judicata* where the patent in suit had been adjudged invalid in litigation with a third party. The prior adjudication operated as a prima facie bar to recovery with the burden on the patent owner to demonstrate "that he did not have 'a fair opportunity procedurally, substantively and evidentially to pursue his claim the first time.' " *Id.* at 333 (citation omitted). The ruling was said to reflect the "consistent view . . . that the holder of a patent should not be insulated from the assertion of defenses." *Id.* at 349.

II.

With this background we turn to the question of whether a license agreement voidable under *Lear* is void *ab initio*, entitling the licensee to recoup royalties already paid. In *Lear* the respective equities of licensee and licensor were balanced in light of the public interest. *See* 395 U.S. at 669-71. As noted by the Court:

> "Licensees may often be the only individuals with enough economic incentive to challenge the patentability of an inventor's discovery. If they are muzzled, the public may continually be required to pay tribute, to would-be monopolists without need or justification." *Id.* at 670.

A.

A rule that licensees can recover all royalties paid on a patent which later is held to be invalid would do far more than "unmuzzle" licensees. It would give the licensee the advantage of a "heads-I-win, tails-you-lose" option. *Lear* states that it is in the public interest to encourage an early adjudication of invalidity of patents. Application of the holding of the District Court could defeat early adjudication of invalidity and encourage tardy and marginal litigation. If the licensee could recover royalties paid (subject to any statute of limitations) on the basis of an adjudication of invalidity accomplished by another litigant, without incurring the expense or trouble of litigation, there would be less inducement for him to challenge the patent and thus remove an invalid patent from the competitive scene. He would be more likely to wait for somebody else to battle the issue because he would have nothing to lose by the delay.

Rather than stimulating early litigation to test patent validity, such an interpretation of *Lear* would make it advantageous for a licensee to postpone litigation, enjoy the fruits of his licensing agreement, and sue for repayment of royalties near the end of the term of the patent. When a licensed patent is about to expire and the threat of injunction no longer exists, a licensee would have little to lose in bringing an action to recover all the money he has paid in royalties on the ground of the invalidity of the patent. The licensee would have a chance to regain all the royalties paid while never having been subjected to the risk of an injunction. Such an interpretation of *Lear* would defeat one of the expressed purposes of the court in announcing that decision.

B.

Further, the interpretation of *Lear* adopted by the District Court inevitably would discourage the licensing of

patents. A patent is a form of intellectual property. The licensing of patents is a business of considerable magnitude.[4]

Under the decision of the District Court, any person who has licensed his invention or patent would have a continuous cloud over any payment of royalties made to him. The cloud might take the form of limiting his credit because of contingent liability. He would be compelled to retain all royalties received in a relatively liquid state until the expiration of the licensed patent, or the running of the applicable statute of limitations. If the licensor should put royalties to work by investing them, a subsequent requirement of repayment could result in the sudden disruption of the investment. The royalties would be taxable to the licensor as ordinary income. *See Fawick* v. *Commissioner*, 436 F.2d 655 (6th Cir. 1971). Thus royalties from patent licenses, being currently taxable but not distributable as profits or usable to operate or expand a business, could constitute a burden on all except the largest and most wealthy licensors. It is entirely logical to anticipate that the owner of more than one patent would demand higher royalties for each in order to hedge against the possibility that royalties received under one patent might be returned to licensees.

C.

An even more serious consequence of requiring royalty refunds with respect to patents held to be invalid is that it would deter inventors from resorting to the patent sys-

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[4] The amicus brief of the American Patent Law Association contains this statement: "Studies show that about 27% of assigned patents (i.e. about 150,000) are put in use at least in part by licensing. Government figures show annual license fees for foreign patent rights to be over $700 million and for all patents to be $1,500 million." (Citing U.S. Department of Commerce Survey of Current Business, October 1971, at page 27).

tem in the first instance. The framers of the Constitution recognized the importance of promoting progress of science and the useful arts. (U.S. Constitution, Art. I, § 8, Cl. 8). They also recognized that it was important to encourage invention and the public disclosure of inventions to "add to the sum of useful knowledge." *Graham* v. *Deere Co.*, 383 U.S. 1, 6 (1966).

Soon after making a discovery, an inventor must decide whether to protect his invention by a patent or to maintain it as a trade secret. It is public policy to encourage the disclosure and public use of ideas as opposed to the maintenance of trade secrets. The exclusive rights conferred by a patent grant are designed not only to encourage invention, but more importantly, to disclose the invention to the public. It is through disclosure that others will be given the opportunity to improve on the invention. If an investor must face the possibility of refunding all patent royalties collected by him, he may be encouraged to keep secret an invention which otherwise might have been disclosed through patent process.

D.

It may be argued that the owner of a valid patent has nothing to fear from the result reached by the District Court—that it is only those whose patents are invalid who will feel the pinch. Unquestionably the public interest demands that developers of unpatentable inventions be deterred from acquiring or enforcing patent protection. However, Judge Learned Hand's observations on patentability should be kept in mind:

> "That issue is as fugitive, impalpable, wayward, and vague a phantom as exists in the whole paraphernalia of legal concepts. It involves, or it should involve, as complete a reconstruction of the art that preceded it as is possible. The test of invention is the originality

of the discovery, and discovery depends upon the mental act of conceiving the new combination, for substantially every invention is only a combination. Nothing more illusory, as nothing is more common, than to assume that this can be measured objectively by the magnitude of the physical readjustments required. . . . When all is said, we are called upon imaginatively to project this act of discovery against a hypostatized average practitioner, acquainted with all that has been published and all that has been publicly sold. If there be an issue more troublesome, or more apt for litigation than this, we are not aware of it." *Harries* v. *Air King Prod. Co.*, 183 F.2d 158, 162 (2d Cir. 1950).

E.

We hold that *Lear* did not overrule *Drackett Chem. Co.* v. *Chamberlain Co.*, 63 F.2d 853 (6th Cir. 1933), and that the rationale of *Drackett* remains the law of this Circuit except insofar as is expresses the licensee estoppel doctrine.

III.

Troxel relies upon the following language of *Lear:* "For all these reasons, we hold that Lear must be permitted to avoid payment of all royalties occurring after Adkins' 1960 patent issued if Lear can prove patent invalidity." 395 U.S. at 674. It is urged by Troxel that *Lear* said that payment of royalties on an invalid patent could be avoided from the time the patent issued, and not merely from the time the patent was declared to be invalid.

"It is a maxim, not to be disregarded, that general expressions, in every opinion, are to be taken in connection with the case in which these expressions are used." *Cohens* v. *Virginia*, 19 U.S. (6 Wheat) 264, 398 (1821) (Marshall, C.J.). Applying this maxim, we read the above-quoted language in *Lear* in the light of the facts that were before the Court in that case.

Lear had been denying liability for royalties during the entire life of the patent, the license agreement having been entered into before a patent issued. 395 U.S. at 657-58. The license agreement called for royalties based upon the use of the alleged invention both before the patent issued and during the life of any patent which might issue. Prior to the issuance of the patent, Lear as licensee notified Adkins as licensor that it had found a patent which it believed fully anticipated Adkin's discovery. Lear terminated all payments under the agreement prior to the issuance of the patent. 395 U.S. at 650-60. The patent issued in 1960. No royalties were paid after issuance of the patent. Therefore, the above-quoted language of the Supreme Court must be construed in the light of the issue actually before the court, namely, that of licensee estoppel. We do not construe the decision of the Court, in overruling the doctrine of licensee estoppel, to require that a licensor should be compelled to repay all royalties received from its licensees under a license agreement where the patent subsequently is held to be invalid.

IV.

In reaching its decision, the District Court relied upon principles of equity, saying: "We cannot, however, see why a licensee who has paid royalties should be in a worse position than one who has not. Moreover, the licensor who has to pay back royalties at least has had the use of the licensee's money."

To the contrary we conclude that the decision of the District Court reaches an inequitable result. Absent fraud or misconduct,[5] a patentee should not be held responsible for

[5] It has been held, without reliance on *Lear*, that a licensee is entitled to recoupment of royalties paid when the licensed patent was procured fraudulently. *See Nashua Corp.* v. *RCA Corp.*, 431 F.2d 220, 227 (1st Cir. 1970); *SCM Corp.* v. *Radio Corp. of America*, 318 F.Supp. 433, 470-72 (S.D. N.Y. 1970); *Schokbeton Prod. Corp.* v. *Exposaic Indus., Inc.*, 308 F.Supp. 1366 (N.D. Ga. 1969). There is not the slightest suggestion in this record of any wrongful conduct by Schwinn in the procurement of the Brilando patent.

the issuance of an invalid patent. Patents are creations of Government, issued after examination by the United States Patent Office. This examination includes "a thorough investigation of the available prior art relating to the subject matter sought to be patented" and an evaluation of patentability by the patent examiner. See 37 C.F.R. § 1.104. Schwinn's patent was held invalid by the California District Court and by the Court of Appeals for the Ninth Circuit in view of such "available prior art". In these circumstances, once a patent has been declared invalid by a court, we do not consider it equitable to require the disenfranchised patentee to refund to all licensees all royalties that have been collected under licensing agreements prior to the adjudication of invalidity.

We hold that neither equity nor public policy require that Troxel be permitted to recover the royalties it paid to Schwinn. Before entering into the licensing agreement Troxel was provided with a copy of the Schwinn patent and had access to the file history of the prosecution of that patent before the Patent Office. Troxel could have challenged the patent initially instead of taking a license. It could have done so at any time after the license agreement was executed. It failed to take this action. It waited for someone else to challenge the patent. Even after another litigant had undertaken the challenge and had been successful at District Court level, Troxel did not join in that challenge but instead elected to remain a royalty-paying licensee. During all this time it had the benefit of freedom from suit for infringement and agreement of Schwinn to attempt to halt unlicensed infringers. It also enjoyed freedom from liability for past infringement.

Finally, on the licensee's side of the balance, the equities are less compelling than those in *Lear*. Typically, "any royalty payments [are] passed on to the consumers [and] are as a practical matter unrecoverable by those who in fact paid them." *Blonder-Tongue, supra,* 402 U.S. at 346.

V.

The public interest is protected adequately under *Lear* without imposing on the patent holder the obligation to refund royalties paid under the license of a patent procured and asserted in good faith. A license may at any time cease royalty payments, secure in the knowledge that the invalidity of the patent may be urged when the licensor sues for unpaid royalties. *Lear, supra.* If the patent is declared invalid through the efforts and expenditures of another, no further royalties are due under the license agreement. *Drackett Chem. Co.* v. *Chamberlain Co., supra,* 63 F.2d 853. Further, if the evicted licensee is sued as an infringer, the prior adjudication of invalidity enables the licensee to secure pretrial judgment in his favor. *Blonder-Tongue, supra,* 402 U.S. 313. To permit a licensee in addition to recoup royalties paid is to extend *Lear* far beyond its rationale. Congress has not seen fit to create an implied warranty of validity in license agreements. We decline to do so by judicial action.

VI.

The sole remaining issue is the disposition of Schwinn's counterclaim for royalties due for goods sold during the last quarter of 1970. *Lear* makes it clear that Troxel may defend against this counterclaim on the ground that the Brilando patent is invalid. Further, the Ninth Circuit ruling of invalidity is "available [as] an estoppel defense that can be pleaded affirmatively and determined on a pretrial motion for judgment on the pleadings or summary judgment." *Blonder-Tongue, supra,* 402 U.S. at 348.

Reversed and remanded with directions to dismiss Troxel's complaint and to make appropriate disposition of Schwinn's counterclaim.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Nos. 73-1330-31

THE TROXEL MANUFACTURING COMPANY, *Plaintiff-Appellant and Cross-Appellee,*

v.

SCHWINN BICYCLE COMPANY, *Defendant-Appellee and Cross-Appellant.*

APPEAL from the United States District Court for the Western District of Tennessee, Western Division.

Decided and Filed December 19, 1973.

Before PHILLIPS, Chief Judge, WEICK, Circuit Judge, and O'SULLIVAN, Senior Circuit Judge.

PHILLIPS, Chief Judge. This is the second appeal in patent royalties litigation between the licensee of a patent (Troxel) and the owner of the patent (Schwinn) where the patent ulitmately was ruled to be invalid. Reference is made to the earlier decision of this court reported at 465 F.2d 1253 (6th Cir. 1972) [hereinafter cited as *Troxel I*] for details of the background of the case.

Troxel was a licensee under the Schwinn patent. The patent was held invalid by a California District Court on January 3, 1969.[1] The United States Court of Appeals for the Ninth Circuit affirmed on December 22, 1970.[2]

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[1] 160 U.S.P.Q. 587.

[2] *Schwinn Bicycle Co.* v. *Goodyear Tire & Rubber Co.*, 444 F.2d 295 (9th Cir. 1970).

In *Troxel I* this court held, among other things, that: (1) Troxel was not entitled to recover all the royalties it had paid to Schwinn from the inception of the license agreement; (2) the eviction of the patent occurred on December 22, 1970, the date of the Ninth Circuit decision of invalidity; and (3) Troxel was not entitled to recover royalties for any period prior to the eviction, i.e., December 22, 1970.

Also involved in this litigation is Schwinn's counterclaim for the final quarterly royalty payment asserted to be due under the license agreement for the last quarter of 1970.

The District Court [3] had ordered Schwinn to refund to Troxel all royalties collected under the license agreement. In *Troxel I* this court reversed and remanded with directions to dismiss the complaint and to make appropriate disposition of Schwinn's counterclaim for royalties asserted to be due for the last quarter of 1970.

In the proceedings in the District Court on remand, Troxel moved to amend its pleadings to set forth an alternative theory of recovery, which it contends is consistent with the holding of this court in *Troxel I*. The District Court denied leave to amend. The District Court also denied Schwinn any recovery under its counterclaim for royalties for the last quarter of 1970. All other motions were denied and costs were taxed against Troxel.

Both Troxel and Schwinn have appealed to this court. Troxel appeals from the denial of its motion to amend its pleadings so as to aver an alternative theory of recovery. Schwinn cross-appeals from the denial of its counterclaim for royalties for the final quarter of 1970.

We affirm as to the denial of Troxel's motion to amend its pleadings. We reverse as to the action of the District Court on Schwinn's counterclaim and remand for entry of judgment in favor of Schwinn for royalties found to be owed by Troxel for the period prior to December 22, 1970.

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[3] 334 F.Supp. 1269.

(1) *Motion to Amend*

Troxel strenuously contends that denial of its motion for leave to amend, especially in the absence of stated reasons, was an abuse of discretion. We disagree.

The grant or denial of a motion for leave to amend is within the sound discretion of the District Court and will be reversed only for an abuse of discretion. *Zenith Radio Corp.* v. *Hazeltine Research, Inc.*, 401 U.S. 321, 330 (1971); *Foman* v. *Davis*, 371 U.S. 178, 182 (1962). Rule 15(a), Fed. R. Civ. P., mandates that leave to amend "shall be freely given when justice so requires."

In *Foman* v. *Davis*, *supra*, the Supreme Court set forth the guidelines governing motions to amend under Rule 15(a). They are as follows:

> "Rule 15(a) declares that leave to amend 'shall be freely given when justice so requires'; this mandate is to be heeded. See generally, 3 Moore, Federal Practice (2d ed. 1948), ¶¶ 15.08, 15.10. If the underlying facts or circumstances relied upon by a plaintiff may be a proper subject of relief, he ought to be afforded an opportunity to test his claim on the merits. In the absence of any apparent or declared reason—such as undue delay, bad faith or dilatory motive on the part of the movant, repeated failure to cure deficiencies by previously allowed, undue prejudice to the opposing party by virtue of allowance of the amendment, futility of amendment, etc.—the leave sought should, as the rules require, be 'freely given'. Of course, the grant or denial of an opportunity to amend is within the discretion of the District Court, but outright refusal to grant the leave without any justifying reason appearing for the denial is not an exercise of discretion; it is merely abuse of that discretion and inconsistent with the spirit of the Federal Rules." 371 U.S. at 182.

These guidelines are founded on the hornbook proposition that peicemeal litigation should be discouraged, not

only because it is antagonistic to the goals of public policy, but also because it is prejudicial to the rights of individual litigants.

With these considerations in mind, we come to the facts of this case. Troxel has moved to amend its pleadings to assert an alternative theory of recovery based on an August 31, 1967, modification of the license agreement. This modification has been of record in the case since September 20, 1971. The only excuse offered for this delayed presentation is that Troxel misconceived the law. Troxel now seeks to present a theory of law that is alleged to be consistent with the prior law in this Circuit as reaffirmed by *Troxel I.*

A misconception of the law is not an excuse for the late presentation of an alternative theory of recovery. No reason is shown why Troxel could not have presented its alternative theory initially. *Drackett Chemical Co.* v. *Chamberlain Co.*, 63 F.2d 853, 858 (6th Cir. 1933), the case relied on, was and still is the law of this Circuit. That Troxel misconceived the effect of *Lear* v. *Adkins*, 395 U.S. 642 (1969), is of no consequence. A losing party can always argue in retrospect that he misconceived the law. Rule 15(a) mandates more of a showing than Troxel has presented here.

As pointed out by the Supreme Court in *Zenith* v. *Hazeltine, supra*, a trial court is required to take into account any prejudice that the party opposing the motion to amend would suffer. Here the prejudice to Schwinn is obvious. The case has been pending for more than two and one-half years, and Schwinn already has had to defend against one theory at both the district court and the appellate court level. The District Court would have been justified in concluding that to put Schwinn through the time and expense of continued litigation on a new theory, with the possibility of additional discovery, would be manifestly unfair and unduly prejudicial.

Troxel places primary reliance on *Foman* v. *Davis, supra.* In *Foman* the District Court had entered judgment and dis-

missed a complaint for failure to state a claim upon which relief could be granted. One day later, the plaintiff moved to vacate the judgment and amend the complaint to state an alternative theory of recovery. These motions were denied and the Court of Appeals affirmed. That decision was reversed by the Supreme Court.

The present case is readily distinguishable from *Foman*. In *Foman* the plaintiff had not attained a decision on the merits of his cause of action. The lawsuit was barely underway when it was terminated. Here Troxel proceeded under one theory through the Court of Appeals where it lost. Now it wants to repeat the whole cycle again. We are unwilling to reverse the decision of the District Court. The time has come to bring this extended litigation to an end.

Other authorities cited by Troxel do not force a contrary conclusion. In *Western Urn Mfg. Co.* v. *American Pipe & Steel Co.*, 308 F.2d 333 (D.C. Cir. 1962), a motion to amend was allowed after a reversal and remand because of new facts. Here there are no new facts. *Jones* v. *St. Paul Fire & Marine Ins. Co.*, 108 F.2d 123 (5th Cir. 1939), was an equity case where the court allowed the plaintiff leave to amend its complaint to assert an additional claim arising out of the same facts. Troxel already has asserted its claim and is merely seeking to justify it with a different legal theory.

We hold that it was not an abuse of discretion for the District Court to deny Troxel leave to amend its pleadings.

In so holding, we note that the better practice is for a district court to state reasons for its denial of a motion to amend. However, as the court said in *Foman* v. *Davis*, *supra*, when reasons are readily apparent it is not per se an abuse of discretion to omit them. *See also Komie* v. *Buehler*, 449 F.2d 644, 648 (9th Cir. 1971).

In order to foreclose any doubts as to the equities of the matter, we hold that even if leave to amend had been al-

lowed, Troxel could not have been successful on its alternative theory. Troxel's new theory is as follows:

> "The theory of recovery proposed to be submitted by Troxel on remand is that the parties, by amendment to the patent license agreement between them, have stipulated that on termination of the agreement, their rights relative to the validity of the patent are to be the same as if there had been no license agreement. Absent a license agreement, it is made clear by *Drackett* that there is a complete failure of consideration where the underlying patent is invalid. Such failure of consideration has long been recognized as a ground for recovery of moneys paid."

The amendment to the license agreement is as follows:

> "Adverting to Section 2 of the license agreement dated June 1, 1967: On the basis of our consideration of the several specimens of your current saddles, we concur that the saddles now designated by you as Series 100 and Series 200 are subject to the royalty provisions of Section 2 of the license agreement and that Series 11 and Series 14 are not.
>
> "It is further agreed that if the license agreement of June 1, 1967, is terminated for any reason, both Troxel and Schwinn, insofar as the question of the validity and scope of said patent is concerned, shall be deemed to be in the same positions after such termination has become effective as they would have been if the license agreement had never been entered into."

In an effort to rely on the rationale of *Drackett Chemical Co.* v. *Chamberlain Co., supra,* Troxel contends that this modification makes the contract void *ad initio* and entitles it to a complete refund of all royalties paid. This interpretation would sidestep completely our holding in *Drackett,* as reaffirmed in *Troxel I,* by eliminating the effect of

any benefits Troxel may have received as consideration for the royalty payments. We hold this to be an untenable position.

The contract modification was pre-*Lear* and provided that the parties shall be deemed to be in the same position *after such termination has become effective* as they would have been if the license agreement had never been entered into. This amendment does not void the contract *ab initio*, but rather gives Toxel the right to contest the validity and scope of the patent *after* termination of the license agreement.[4]

Aside from, and in addition to, the contract argument, Troxel contends that it is entitled to recover solely under the rationale of *Drackett*. This court noted in *Drackett* that an eviction will termine a patent license agreement. The court stated:

> "Prior to such eviction, the mere invalidity of the patent is properly held not to be a sufficient defense, because the licensee may still continue to enjoy all the benefits of a valid patent. It may be respected, and the licensee would then have just what he bargained for." 63 F.2d at 854.
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> "Licenses may be exclusive, partially exclusive, or nonexclusive. The principles which we have stated apply with equal force to all these types. . . . " *Id.* at 855.

In *Troxel I* we held that, absent a bad faith appeal, the eviction occurred on December 22, 1970, the date of the Ninth Circuit's holding of invalidity. 465 F.2d at 1255. There has been no showing that Schwinn prosecuted its appeal in that case in bad faith.

Troxel's position is that it received no benefits from the license agreement. In *Troxel I* we stated:

> "During all this time it had the benefit of freedom

[4] The contract was terminated effective December 22, 1970, the date of the Ninth Circuit's holding of invalidity, and we are concerned only with royalties for the products sold before then.

> from suit for infringement and agreement of Schwinn to attempt to halt unlicensed infringers. It also enjoyed freedom from liability for past infringement." 465 F.2d at 1260.

Troxel disagrees by contending that these benefits can not provide support for the royalties, relying on *Lear* v. *Adkins, supra,* 395 U.S. 653 (1969). Again we reject this argument.

In *Lear* the Supreme Court weighed equities when it discussed contract consideration. The precise issue was licensee estoppel, and the Court was primarily concerned with the existence of unchallenged patents and their effect on competition. This is an entirely different situation from the case at bar. Here the patent already has been challenged and invalidated. Troxel seeks to recover all royalties that it previously had paid, even though it received numerous benefits. We reaffim our prior holding that the equities weigh heavily against Troxel. 465 F.2d at 1257-60. Troxel is not entitled to a refund of any royalties paid prior to the eviction of the patent on December 22, 1970.[6]

(2) *The Counterclaim*

In *Troxel I* we remanded with directions to dismiss Troxel's complaint and make appropriate disposition of Schwinn's counterclaim. We stated:

> "The sole remaining issue is the disposition of Schwinn's counterclaim for royalties due for goods sold during the last quarter of 1970. *Lear* makes it clear that Troxel may defend against this counterclaim on the ground that the Brilando patent is invalid. Further, the Ninth Circuit ruling of invalidity is

[6] Reference is made to *Ransburg Electro-Coating Corporation* v. *Spiller and Spiller, Inc.*, —— F.2d —— (Nos. 72-1496-97, 7th Cir. Nov. 16, 1973), in which the Court of Appeals of the Seventh Circuit adopted the rationale of *Troxel I*.

> available [as] an estoppel defense that can be pleaded affirmatively and determined on a pretrial motion for judgment on the pleadings or summary judgment.' *Blonder-Tongue, supra,* 402 U.S. at 348, 91 S.Ct. at 1452." *Id.* at 1260.

This counterclaim was to be disposed of in light of the following preceding statement:

> "A licensee may at any time cease royalty payments, secure in the knowledge that the invalidity of the patent may be urged when the licensor sues for unpaid royalties. *Lear, supra.* If the patent is declared invalid through the efforts and expenditures of another, no further royalties are due under the license agreement. *Drackett Chem. Co.* v. *Chamberlain Co., supra,* 63 F.2d 853. Further, if the evicted licensee is sued as an infringer, the prior adjudication of invalidity enables the licensee to secure pretrial judgment in his favor. *Blonder-Tongue, supra,* 402 U.S. 313, 91 S.Ct. 1434, 28 L.Ed.2d 788. To permit a licensee in addition to recoup royalties paid is to extend *Lear* far beyond its rationale. Congress has not seen fit to create an implied warranty of validity in license agreements. We decline to do so by judicial action." *Id.*

Troxel did not cease royalty payments prior to the Ninth Circuit's holding of invalidity. *Drackett* makes it clear that Troxel cannot avoid liability for royalties prior to this date. The court in *Drackett* stated:

> "It is only when, by judicial decree or otherwise, it is published to the world that the monopoly is destroyed, that the licensee can claim a corresponding release from his obligation to pay royalties." 63 F.2d at 854.

It was our intention in *Troxel I* that the District Court on remand would compute royalties due for products sold prior to the eviction and enter judgment for this amount against Troxel.

The District Court's denial of relief to Schwinn on its

counterclaim and granting of Troxel's motion for summary judgment on the counterclaim is reversed.

The District Court is directed to compute the amount of royalties due for the last quarter of 1970 and enter judgment against Troxel for that amount. These royalties are to be computed for the period embracing the fourth quarter of 1970 and ending on December 22, 1970, the date of eviction of the patent.

We hold that Schwinn is not entitled to recover double costs, damages or attorney's fees. The costs on these cross-appeals will be taxed against Troxel.

The case is remanded for further proceedings not inconsistent with this opinion.